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## Vermont Military Retirement Taxation Information Paper

### Background

Vermont is one of very few states that taxes the vast majority of military retirement benefits. This puts us at a significant disadvantage when recruiting and retaining service members for our Vermont National Guard (VTNG). Two-Thirds of VTNG members are part-time, which means they are not only part of our National Guard workforce, but they are also part of our civilian workforce. We have an acute workforce shortage in Vermont in nearly every sector of the economy and every region of the state. Attracting and retaining more members of the Vermont National Guard will strengthen our state's workforce. In turn, eliminating the tax on their retirement benefits means more are likely to stay here after retirement and continue to be part of our workforce. At present, a majority of military retirees leave Vermont. They go to places like Tennessee, South Carolina, Florida, Texas, or move just across the border to New Hampshire.

We have an opportunity to increase the number of military retirees who stay in Vermont. This will grow our workforce and help us retain talent in Vermont. At present, according to [wallethub.com](http://wallethub.com), Vermont ranks 49<sup>th</sup> of 51 states and Washington, DC for best places for military retirees. Their formula is straightforward, incorporating economic environment rank, quality of life rank and health care rank – each with a weight of 33.33% for scoring. In all three categories, Vermont does not climb out of the bottom 10 (including quality of life). According to [Kiplinger.com](http://Kiplinger.com), Vermont is in the bottom 10 for worst states to retire in due to taxes, with military pensions, Social Security, other pensions and distributions from 401k and IRAs being subject to taxes. The current legislation sets \$50,000 Gross Adjusted Income as the cap to get the first full \$10,000 exemption from income tax. \$50,001 - \$60,000 is partial, over \$60,000 is zero. When considering rank structure of military retirees, this applies to nearly no one. For instance, a traditional drilling Vermont National Guard (VTNG) member would have to retire as a lower ranking non-commissioned officer to receive this benefit, and only then at age 60.

### Workforce Development

I have worked to grow the Vermont workforce through partnerships with Vermont employers, initiating our Partnered Recruiting Initiative for Military and Employers (PRIME). This program provides VTNG members, their spouses and working age dependents an opportunity for an interview with participating employers. At this juncture, we have 26 employers as partners and a like number in the queue pending partnership. The challenge is one of bringing talent to Vermont and keeping the talent we have – the VTNG is invested in this effort. In the past year, the VTNG has lost 8 Airmen and 58 Soldiers who have moved out of Vermont for employment in other states, to find more robust support systems and to seek stability in retirement.

Historic data from 2004 to 2019 shows incremental growth of the retiree population, from 3402 to 3904. From 2014 to 2021, **475 members** of the VTNG retired. What is of note is from 2014 to 2019, the military retiree population only grew incrementally from 3810 to 3904. While I do not have the Vermont military retiree population data for 2020-2024, the trend is clear - we are not keeping our military retirees, nor are we attracting this talent to Vermont. From the Vermont Joint Fiscal Office, the total annual payment to military

retirees by the Department of Defense is \$81,969,000 (from the JFO Issue Brief February 2021). Comparatively, like sized states (by population) that do not tax military pensions have a greater number of military retirees and receive an according economic benefit. While most have larger population that may facilitate a greater number of military retirees, we can do better.

Military Retiree Populations 2023

	<u>Population</u>	<u>Military Retirees</u>
VT –	647,464	3904
ME –	1.4m	11,894 (3x military retirees vs VT)
NH –	1.4m	9,533 (2.4x military retirees vs VT)
SD –	924,669	8,812 (2.2x military retirees vs VT)
ND –	796,568	5,437 (1.4x military retirees vs VT)
WY -	586,485	5,638 (1.4x military retirees vs VT)
AK -	733,406	10,908 (2.8x military retirees vs VT)
RI -	1.09m	5,335 (1.4x military retirees vs VT)

Recruiting Talent and the Prior Service Market

Vermont can, and should, make itself more attractive, specifically in the prior service military market. These are individuals who have completed their first term of service and are separating from the active-duty military, normally after four to six years. Not taxing military pensions is an important tool in making Vermont a destination for prior-service active-duty military members as well as military retirees. The VTNG is focusing our efforts on recruiting specifically to this population of junior to mid-grade non-commissioned officers and junior officers. Many are eligible to continue their military service as traditional (part-time) members of the VTNG. These prior service members do not need to complete basic training and bring a depth of experience to Vermont and our Guard. They have a work ethic, some level of security clearance, and skills that can cross walk into employment opportunities in Vermont. Further, this group typically fall into the exact age band our state is working to attract to live and raise their families here.

It is incumbent upon us to make Vermont attractive, and work overtly to market Vermont and the VTNG to the prior-service population. For example: Fort Drum, NY is our closest major active-duty installation, comparatively small with a Soldier population of around 15,000. Anticipating their annual attrition rate (those separating from the service) at around 12%, that indicates 1,800 Soldiers separate from Fort Drum every year. In consideration of other active-duty installations for both Air Force and Army, that number becomes exponential. Fort Cavazos, TX, for instance, has an active-duty Soldier population of 38,642; Fort Liberty, NC has an active-duty population of over 55,000; Nellis Air Force Base, NV has population of nearly 15,000 Airmen; Hill Air Force Base, UT has a population of 5,500 Airmen. Further, other components (USN, USMC) have significant active-duty populations we can recruit from.

The military retiree system has changed from the historic required 20 years to earn a pension. Since January 1, 2018, members of the military participate in a modernized retirement plan that combines a traditional pension with contributions to the Thrift Savings Plan (TSP). There are four elements to the Blended Retirement System (BRS):

- A defined benefit plan, similar to the legacy pension
- A defined contribution plan (TSP)
- Continuation pay (a mid-career incentive)
- Lump sum pay, which allows service members to take up to 50% of their retired pay up front

If the VTNG can grow our ranks, and Vermont can grow the population of military retirees, the projected loss of only \$2.8m tax revenue will become a significant net gain. These retirees and new VTNG members will bring their families to Vermont, buy homes and cars and goods, seek employment, pay taxes, help to fill our schools and universities, volunteers in our local communities and be contributing members of the Vermont workforce.

An active-duty military member who enters the service at 18 and serves 20 years to earn a legacy pension/defined benefit plan would be 38 years old at retirement with plenty of time and great skills to have a whole second career ahead of them. They would have another 20+ years to work and live in Vermont, pay taxes and contribute to their community and the economy while their military pension is not taxed. Traditional drilling members of the National Guard, however, may follow the same career path and retire at age 38, however, they will not see any retired pay until age 60 (a “grey area” retiree). After waiting 22 years to draw their military pension, they will soon be able to also collect Social Security – and under our current system, have both taxed by the state of Vermont. This presents a disincentive to retire here, as exemplified by our small number of military retirees.

### Survivors

Vermont has a small population of 751 military retiree dependents who receive compensation under the Survivor Benefit Plan (SBP). Members of the military can elect to participate in SBP, allowing a retiree to ensure, after death, a continuous lifetime annuity for their dependents. The maximum SBP annuity is based on 55% of the members retired pay. Vermont is one of 48 states that fully taxes these benefits, along with California. The premiums for SBP are paid with pre-tax dollars, excluded from taxable income. Cost for SBP vary, determined by base amount and who is covered. For example, a military retiree receiving \$2000 monthly pays 6.5% for spouse coverage, a total of \$130 a month.

### The Commitment

For the past several years, some present a narrative that not taxing military pensions means Vermont would have to do the same for others like First Responders (who do amazing work). Conflating tax relief for the military with First Responders is inaccurate. Members of the military, specifically the VTNG, sign a contract and swear an oath to support and defend the Constitution. One cannot simply walk away from that commitment. We have a dual mission, responding to orders of the Governor during times of civil emergency, and concurrently preparing for and executing our federal mission during deployments. Members of the VTNG are required to be away from their families and

employers for at least one weekend a month and two weeks a year – but generally more with deployments locally and federally. They are also required to complete their Professional Military Education in order to be advanced, which is another time requirement of anywhere from 22 days to over a year for some courses. Federal deployments to combatant commands across the globe are anywhere from 90 days to a year. We miss significant life events – birthdays, anniversaries, graduations, birth of a child. We respond to domestic emergencies often at a moment's notice, like recent flooding in Vermont and the COVID pandemic (and all that entailed). We do this in service our communities state and nation. This sacrifice, dedication and commitment is significant and unlike any other role.

### The Ask

Vermont must address its demographic crisis of fewer and fewer working-age residents and a growing number of senior citizens. There are simply not enough workers to keep our economy going or growing. For our state to be a more affordable place for all of us, we must address this crisis head on. Having military pensions exempted from tax provides a valuable tool to both Vermont and the Vermont National Guard to do just that. Two thirds of our force serve as traditional drilling part-time members, so they are either students or have a dual career in the civilian workforce. Incentivizing military service by reducing the tax burden makes good economic sense, especially considering most other states provide greater tax benefits to military retirees.

By leveraging the marketing capability of state government and the VTNG, we can make Vermont a destination for both military retirees and prior service members of the military who can continue service in our Guard. At present, the VTNG can fill over 700 vacancies. Should we be successful, the VTNG can grow opportunities for Vermonters, our employers, colleges and universities, and increase our capacity and capability to respond to both our domestic and federal missions. This would also add tens of millions of dollars to the approximately \$152 million in pay and allowances currently coming to Vermont from the VTNG annually and enable us to more readily pursue military construction projects to replace our aging infrastructure.

For these reasons, we ask that you move to eliminate the tax on military retirement benefits this legislative session.



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